

February 15, 2018

By electronic submission to regs.comments@federalreserve.gov

Ms. Ann E. Misback, Esq.
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Proposed Guidance on Supervisory Expectations for Boards of Directors (Docket No. OP-1570)

Ladies and Gentleman:

Credit Suisse Group AG and its designated U.S. intermediate holding company (“IHC”), Credit Suisse Holdings (USA), Inc., thank you for the opportunity to comment on the proposed supervisory guidance issued by the Board of Governors of the Federal Reserve System (“FRB”) regarding supervisory expectations for boards of directors (“the Proposal”).¹ We strongly support what we see as the two core objectives of the Proposal, as we believe both will result in strengthened board of directors (“board”) oversight of their firms. The first is better distinguishing the roles and responsibilities of the board from those of management, to allow the board to spend less time on routine matters and the “granular specifics of supervisory guidance” and more time “on core board responsibilities,” such as risk oversight.

The second is the movement away from requiring time-consuming and often ineffective “check-the-box” requirements and towards what Governor Powell has characterized as a “principles-based approach” that “recognizes that large firms have a broad range of business models, structures, and practices.”² We agree that there is no “one-size-fits-all” approach to corporate governance. This is particularly true for foreign banking organizations (“FBOs”) and their IHCs, which, as we discuss below, operate under very different circumstances from the boards of top-tier U.S. bank holding companies (“BHCs”).

We also fully support the Proposal’s recommended changes regarding the communication of supervisory findings, which would ensure that most supervisory findings (other than those directly affecting the board) are communicated in the first instance to senior management for corrective

¹ Federal Reserve System, *Proposed Guidance on Supervisory Expectations for Boards of Directors*; 82 Fed. Reg. 37219 (August 9, 2017).

² *Ibid.*

action, allowing boards to focus on their core oversight responsibilities instead of day-to-day remediation of operational issues.

More generally, we welcome the FRB's decision to publish the proposed text of the revised supervisory guidance in this instance, as well as its identification of Supervision and Regulation letters ("SR letters") that ought to be revised in light of the proposed Board Effectiveness Guidance ("BE Guidance") portion of the Proposal. We respectfully request the FRB follow the precedent it has set in the Proposal by inviting public comment on *material* changes to those SR letters. Indeed, we recommend that the FRB subject *all* supervisory guidance, such as SR letters, to notice-and-comment moving forward. Doing so would, in our view, both improve the transparency and effectiveness of the FRB's supervisory guidance.

Summary of Comments

Although we are broadly supportive of the Proposal, we share a number of the overarching concerns expressed by The Clearing House Association and the Institute of International Bankers ("IIB") in their submissions on this subject. In particular, both submissions emphasize the importance of tailoring supervisory expectations to the specifics of the firm's business strategy, risk, and structure, recognizing that there is no one-size-fits-all approach to board governance. Both submissions also address the FRB's request for comment on the potential future application of the BE Guidance and other elements of the Proposal to IHCs, a subject that is the focus of this submission.³

We strongly recommend that the FRB issue IHC-specific guidance relating to board governance. In crafting any proposal applicable to IHCs, the FRB should recognize and explicitly acknowledge in its guidance that although IHC boards share many of the same responsibilities as top-tier BHCs, they function under very different conditions. Specifically, IHC boards must operate within the legal, regulatory, strategic and risk governance framework set by its global parent, and owes fiduciary duties to the parent as its sole shareholder. Specifically, the FRB should, in our view, incorporate the following broad-based principles into any future IHC-specific guidance:

- Emphasize the need for clear, aligned and consistent direction between the parent board and the IHC board. Any future guidance should emphasize the importance of a collaborative relationship between the parent and IHC boards, as well as with the IHC board and global management. A collaborative relationship is vital in order to ensure the dual objectives of the Basel Committee guidelines on the governance of group structures⁴: that is, that "the strategic objectives, risk governance framework, corporate values and corporate governance principles of the subsidiary align with that of the parent company," and that adjustments can be made "where a group policy conflicts with an applicable [local] legal or regulatory provision or prudential rule." Group-wide mechanisms should be put in place to ensure escalation of material concerns or concerns about actions that run counter to Regulation YY requirements⁵ to the parent board. Policies should also be developed that describe how the parent board ought to communicate and collaborate with the IHC board.

³ We note that while the Proposed BE Guidance does not apply to the U.S. IHCs, the FRB anticipates proposing at a later date board effectiveness guidance for IHCs and has therefore requested specific comment on how the proposed BE guidance should be refocused and adapted to apply to boards of IHCs.

⁴ Basel Committee on Banking Supervision, "Guidelines on Corporate Governance Principles for Banks" (July 2015). Available at: <http://www.bis.org/bcbs/publ/d328.pdf>.

⁵ 12 CFR Part 252, Regulation YY, "Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations."

- Recognize that there is no “one-size-fits-all” approach standard for governance as it applies to FBOs. Any future guidance applying to IHCs should be strictly principles-based and allow for flexibility in implementation given the differences in structures/operating models among FBOs. In particular, the FRB should allow for greater flexibility in its supervisory expectations in situations where the firm’s home country has in place corporate governance standards that are substantially equivalent to U.S. standards; where the firm’s parent board is already heavily independent of management; and where U.S. regulators have a strong working relationship with the parent firm’s home country regulator. This no “one-size-fits-all” approach should be extended to expectations surrounding the composition of IHC boards, which should not, in our view, exceed requirements already mandated by Regulation YY⁶ or requirements as to individual IHC board members.

We believe that these principles will help ensure global strategy, risk, capital, liquidity and resolution and recovery policies are well aligned, while better enabling IHC boards to fulfil their responsibilities under Regulation YY. We also believe that it would enhance communication and coordination during periods of potential stress, thereby reducing the likelihood of resolution and contagion risk in the system.

In addition to advancing the above principles in any future guidance applicable to IHCs, we also wish to raise the following subjects in this letter:

- First, in recognition of IHC matters often being global firm matters that involve multiple regulatory bodies, we encourage the FRB to work with the firm’s home country regulator to ensure that the IHC and parent boards do not receive conflicting guidance or are unable to satisfy the requirements of one regulator when awaiting a response from another regulator.
- Second, we ask that the FRB clarify the IHC board’s responsibility for those parts of an FBO’s Combined U.S. Operations (“CUSO”) that are outside of the IHC.
- Third, we identify a number of SR letters that are not listed in Table A of the Proposal that we believe should be rescinded or revised to better align them with the BE Guidance, as well as overarching principles that should guide the FRB as it makes those revisions.
- Fourth, while we believe that it is best practice for boards to engage in periodic “lessons-learned” or “self-assessment” exercises, we concur with other commenters that such assessments should be confidential, and neither shared with supervisors nor used as the basis for supervisory evaluations of the effectiveness of boards.
- Finally, we seek clarity on the applicability of the changes in the Proposal to IHCs in light of proposed changes to the ratings system for large financial institutions (“LFI Rating System Proposal”).⁷

In the remainder of the letter we provide more detailed comments on select parts of the Proposal.

⁶ In terms of board composition, Regulation YY requires IHCs to have a U.S. risk committee of the board consisting of at least one independent member and one member with experience in identifying, assessing and managing risk exposures of large, complex financial firms.

⁷ Federal Reserve System, *Large Financial Institution Rating System; Regulations K and LL*; 82 Fed. Reg. 39049 (August 17, 2017).

Comments on Select Elements of the Proposal

I. Ensuring a Clear, Aligned, and Consistent Direction between the Parent and IHC Boards

An IHC board operates in the context of a global company with a single shareholder that effectively selects its membership, sets a global strategy, a global risk governance framework, corporate governance principles, and corporate values. State corporate law principles (e.g., Delaware law) require boards to act in the best interest of its shareholder or shareholders, generally subject to certain qualifications such as not defrauding creditors and of course other regulation. In this case, that shareholder is its parent. This is a core principle of corporate governance, and important in understanding the relationship between the parent board and the IHC board.

An IHC is, of course, subject to regulation separate and apart from state corporate law. This includes regulation set by the FRB, including requirements pursuant to Regulation YY, and rules set by other prudential regulators, in particular the parent firm's home country regulator. The responsibilities imposed by such regulations are significant, but they can only be executed effectively in cooperation and communication with the parent board and senior global management in order to ensure a clear, aligned, and consistent direction in approach, since those entities set global strategy and a global framework for implementation of that strategy.

Effective compliance with local requirements such as Regulation YY therefore requires close collaboration and communication between the IHC board, the parent board, and senior management. Given that there will inevitably be instances in which the interests of the parent firm and the responsibilities of the IHC board under Regulation YY diverge, there is also a need to put in place mechanisms for escalating items to the parent board and to prevent, or appropriately address, conflicts of interest that could arise.

In our view, there is no one "right way" to ensure effective collaboration and escalation of issues. One approach, which we favor, is cross-representation of the parent board and global management on the IHC board in recognition of the need for the two boards to mutually address a range of issues, including the formulation of strategy; development of capital, liquidity, and resolution plans; and overseeing risk management and internal audit operations. While this structure can work well, other institutions with different structures and business mixes may choose alternative board compositions, and may have other mechanisms for ensuring alignment and effective escalation.

Another mechanism for achieving these goals is the creation of internal governance policies that have obtained the approval of the parent board and the concurrence of the IHC board. These policies should cover a range of issues such as the composition of subsidiary boards; compensation of senior managers with both U.S. and global responsibilities; the nomination/dismissal process for IHC board members; onboarding/training procedures; duties and responsibilities of board members; information sharing between the boards themselves and between the boards and management; and mechanisms for resolving conflicts of interest/escalating items to the parent board in a timely manner. Although the specifics of such policies will vary across firms, we believe that it is critical to have agreed policies in place to facilitate cooperation and ensure effective escalation of issues.

II. Tailor Supervisory Expectations to Home Country/Parent Circumstances

The FRB should tailor its expectations where the home country/parent firm has in place corporate governance regulations and/or operates under standards that are substantially equivalent to U.S. requirements.⁸

III. Ensure Effective Cross-Border Regulatory Cooperation

In recognition of IHC matters often being global firm matters that involve multiple regulatory bodies, we encourage the FRB to work with the parent's home country regulator to ensure that the IHC and parent do not receive conflicting guidance or being unable to satisfy the requirements of one regulator when awaiting a response from another regulator.

IV. Recognize the Governance Challenges Relating to CUSO

Any guidance related to the effectiveness of IHC boards should seek to clarify their responsibility for U.S. entities operating outside of the IHC legal structure i.e. CUSO, including U.S. branches of the firm's parent bank. The guidance should recognize that branches are managed and governed by the parent firm. As such, it is the parent board rather than the IHC board that has the ultimate oversight authority over U.S. branches.

At the same time, many FBO have elected, as a practical matter, to have the risk committee of their IHC board also serve as the risk committee for their CUSO, an action permitted by Regulation YY. The IHC Risk Committee also appoints the U.S. CRO, as required by Regulation YY. Therefore, IHC boards typically have responsibilities for CUSO despite their lack of formal oversight authority over U.S. entities outside of the IHC.

This situation has created significant confusion over the responsibilities of IHC boards. The FRB should make clear that the IHC board's responsibilities for CUSO are limited to those associated with Regulation YY: that is monitoring risk in CUSO and escalating to the parent board as material risks arise. It should also recognize that the IHC board does not have the legal authority to direct the branch to undertake specific actions; such direction can only occur at the parent level.

V. Revisions to Existing Expectations and Requirements for Boards of Directors

We fully support the FRB's comprehensive review of all existing supervisory expectations and regulatory requirements relating to boards, as well as its decision to rescind or revise expectations that are not aligned with the final BE Guidance, beginning with those contained in SR letters. We also generally agree with the common categories of requirements recommended for rescission or revision by The Clearing House Association in its letter.

In brief, we believe that any provisions that contain prescriptive instructions to boards should be re-examined or eliminated. Similarly, letters that assign responsibilities to both "the board and senior management" should in most instances be revised to only refer to "senior management," consistent with the core objectives of the Proposal. The FRB should also clarify and appropriately narrow formal board approval and review requirements to better enable them to focus on core strategies, policies, plans, and procedures. In this regard, we also recommend that boards be able to

⁸ It is worth noting in this instance that Credit Suisse Group, like other Swiss firms, has a fully independent board as required by Swiss banking regulations. This ensures a clear delineation between the roles of the board and management, which is one of the core goals of this Proposal.

rely more heavily on summary documents prepared by management or third parties in exercising their review/approval roles.

The FRB should also appropriately distinguish between its expectations for BHC boards and its expectations for IHC boards in any revisions it makes to SR letters. That, in turn, will likely require finalization of the IHC-specific guidance first to ensure alignment with its core principles. We ask then that the FRB move expeditiously to propose and finalize IHC-specific guidance, and then in short order publish for notice-and-comment its proposed collective changes to the SR letters.

We also note that the FRB is conducting its comprehensive review in two phases, with the second phase “focused on requirements and supervisory expectations set forth in [FRB] regulations or in various forms of interagency guidance.” We fully recognize that this process will take time, particularly when such revisions would involve interagency action (e.g., SR 13-3, Interagency Guidance on Leveraged Lending; SR 11-10, Interagency Counterparty Credit Risk Management Guidance). But, as above, we encourage the FRB to move as quickly as possible to avoid potential conflicts with the finalized BE Guidance and/or a future IHC-specific guidance.

We would also encourage the FRB to reexamine the Federal Reserve's Bank Holding Company Supervision Manual and other supervision manuals as part of this second phase to ensure that it is consistent with the BE Guidance and any future IHC-specific guidance. In addition, we echo the call of others for a “measured” approach by examiners as the FRB conducts this review, and not penalize boards that are focusing on their core responsibilities as envisioned in the Proposal.⁹

Finally, we wish to comment on Table A of the Proposal, in which the FRB identifies SR letters that contain guidance on the roles and responsibilities for boards of directors that would be rescinded and revised. In our view, the following SR letters contain significant and broad-based requirements for boards of directors, and should be included in the FRB's comprehensive review:

- SR 13-1: Supplemental Policy Statement on the Internal Audit Function and its Outsourcing
- SR 11-7: Guidance on Model Risk Management

In addition, the following SR letters include requirements that *may* contain requirements contrary to the objectives of the Proposal, and should therefore be part of phase one of the FRB's comprehensive review:

- SR 13- 24: Managing Foreign Exchange Settlement Risks for Physically Settled Transactions
- SR 12-14 Revised Guidance on Supervision of Technology Service
- SR 12-7: Supervisory Guidance on Stress Testing for Banking Organizations with More than \$10 Billion in Total Consolidated Assets

VI. Do Not Mandate Board Self-Assessments

We concur with the position taken by other commenters¹⁰ regarding the Proposal's discussion of board self-assessments. In our view, it is best practice for boards to conduct periodic self-assessment-style exercises, and to incorporate “lessons learned” into their policies, procedures, and decision-making. However, such assessments should be strictly confidential, and not shared with

⁹ See The Clearing House Association comment letter in response to the Proposal, pp. 21-23.

¹⁰ See, for example, The Clearing House Association (pp. 7-10) and IIB (p. 7) comment letters in response to the Proposal.

supervisors or used as the basis for supervisory evaluations. Doing so would likely have a chilling effect on the board discussions and decision-making, thereby undermining board effectiveness.

In addition, using self-assessments as the basis for supervisory evaluations would breach a core corporate governance precept known as the “business judgement rule.” Under Delaware law, the business judgment rule ensures that deference is granted to decisions of a board in the absence of evidence of a breach in fiduciary duties. This allows boards to conduct their core functions without the chilling effect of *ex-post* evaluation of their actions by others. Supervisory review of the efficacy of good-faith board actions (as would occur if self-assessment results were shared with supervisors) would inappropriately conflict with this fundamental tenant of corporate governance.

We therefore ask the FRB to make clear that a) self-assessments are voluntary exercises that are at the discretion of the board to conduct as it sees appropriate and b) that it has no expectation that any content related to board self-assessments will be shared with Federal Reserve supervisory staff.

VII. Clarify the Applicability of BE Guidance in Light of LFI Rating Proposal and Risk Management Proposal

On the same day that the FRB issued the Proposal, it also issued the aforementioned LFI Rating System Proposal. Under the proposed new rating system, component ratings would be assigned on capital planning and positions, liquidity risk management and positions, and governance and controls, and apply to all FRB-supervised large firms beginning in 2018. The governance and controls component rating would evaluate the effectiveness of a firm’s board of directors, along with the effectiveness of its risk management. Specifically, the BE Guidance would be used as the basis for such an evaluation of board effectiveness, while the effectiveness of risk management would be determined by the FRB’s proposed supervisory guidance describing core principles of effective senior management, the management of business lines, and independent risk management and controls for large financial institutions (hereafter the “Risk Management Proposal”).¹¹

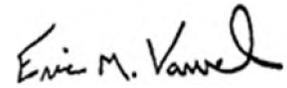
We echo the concern raised by other commenters¹² regarding the possibility of the LFI Rating System and the Risk Management Proposal going into effect before IHC-specific board effectiveness guidance is finalized. That scenario would, in our opinion, create unnecessary confusion about supervisory expectations as it relates to governance and potentially lead to the inappropriate application of standards intended for top-tier BHCs to IHCs. We therefore recommend that, at a minimum, the FRB delay application of the governance and controls portion of the LFI Rating System for both domestic firms and IHCs until IHC-specific board effectiveness guidance and IHC-specific risk management guidance¹³ is issued and finalized. This will reduce confusion about expectations, and ensure a level-playing field for all institutions. At the same time, we want to reiterate our desire for the FRB to move expeditiously to issue and finalize its governance and controls expectations for IHCs and incorporate those into the LFI Rating System.

¹¹ Federal Reserve System, *Proposed Supervisory Guidance (describing core principles of effective senior management, the management of business lines, and independent risk management and controls for large financial institutions)*: 83 Fed. Reg. 1351 (January 11, 2018).

¹² See IIB comment letters on the Proposal and the LFI Rating System Proposal.

¹³ We note that the Risk Management Proposal, in contrast to the proposed BE Guidance, would apply directly to IHCs. We recommend instead that the FRB issue IHC-specific risk management guidance, for many of the aforementioned reasons that we recommend that the FRB issue IHC-specific board effectiveness guidance.

We thank the Board of Governors of the Federal Reserve System for its considerations of our comments. If you have any questions, please do not hesitate to contact the undersigned or Peter J. Ryan (202-626-3306; peter.ryan.3@credit-suisse.com).



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